

# BALTIMORE COUNTY FISCAL DIGEST

## General Fund Revenues & The Economy

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Brian J. Rowe, CPA  
County Auditor

Elizabeth J. Irwin  
Manager, Budget Analysis and  
Fiscal Research

Paul R. Maihan  
Principal Analyst

Adam J. Lumia  
Staff Analyst

Kevin D. Reed  
Staff Analyst

Michelle F. Ganjon  
Legislative Specialist

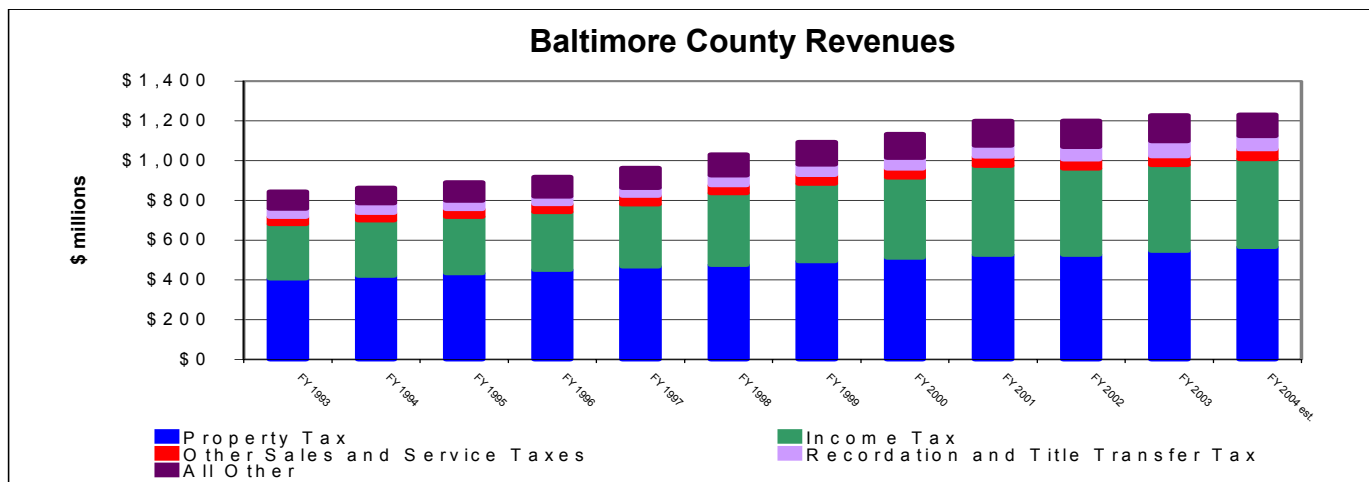
## REVENUE HIGHLIGHTS

**FY 2003 County General Fund revenue** totaled \$1.229 billion, \$28.3 million, or 2.4%, above FY 2002 revenue. The 2.4% increase represents an improvement over FY 2002, when General Fund revenue increased by only 0.1% over the previous year. The past two years' General Fund revenue increases are small by recent historical comparisons and represent growth rates that are well below trend, which has averaged approximately 4.5% over the past decade. Unfortunately, below-trend General Fund revenue growth is expected for at least the next few years; for all of FY 2004, General Fund revenue is expected to grow by only 0.2%. At no time since FY 1970 has General Fund revenue displayed such a weak 3-year performance.

**The FY 2003 General Fund revenue** increase of \$28.3 million was \$19.3 million higher than the original FY 2003 revenue forecast made in May 2002 and reflected lower income tax revenue being offset by stronger-than-expected revenue from property related transfers (due to continued strength in County real estate transactions) and higher-than-expected "other" revenue. FY 2003 highlights:

- The County's largest revenue source, property tax, increased by \$19.9 million, or 3.8%, over FY 2002 collections. Income tax revenue (second largest source) fell by \$3.6 million, or 0.8%, reflecting lower capital gains receipts.
- Property related transfer revenue increased 19.2%, with title transfer tax revenue increasing by 17.1% and recordation tax revenue increasing by a stronger 22.9%.
- General Fund revenue exceeded expenditures by \$25.1 million, bringing the County's surplus to an estimated \$125.1 million, including \$66.0 million in the Revenue Stabilization Reserve Account.

**FY 2004 General Fund revenue** is forecast to increase by \$2.9 million, or 0.2%, to \$1,231.9 million. This forecast is \$10.7 million above the adopted budget and takes into account known reductions in General Fund revenue expected from the State. However, this projection does not take into account additional reductions that may materialize due to State budget difficulties or reduced property tax payments as a result of tropical storm Isabel. For FY 2004, property tax and income tax revenue combined are projected to increase by \$31.1 million, advancing by 3.5% and 2.8%, respectively. On the other hand, property related transfer taxes (recordation and title transfer fees) are projected to fall by a combined \$7.5 million, or 10.0%, due to a slowing real estate market and falling refinancing.



## COUNTY GENERAL FUND REVENUE

### General Fund Revenue FY 2002 – 2004 (Millions of Dollars)

General Fund revenue grew by 2.4% in FY 2003 and by 0.1% in FY 2002. FY 2004 General Fund revenue is projected to grow by only 0.2%. At no time since FY 1970 has General Fund revenue displayed such a weak 3-year performance.

<u>Revenue Source</u>	<u>FY 2002</u>	<u>Adopted Budget FY 2003</u>	<u>Preliminary FY 2003</u>	<u>Estimated FY 2004</u>
Property Taxes	\$527.1	\$545.3	\$547.0	\$566.1
Income Taxes	433.8	438.9	430.2	442.2
Sales & Service Taxes	45.6	45.2	45.2	49.0
Recordation Taxes	22.6	17.6	27.8	25.0
Title Transfer Taxes	40.3	30.0	47.2	42.5
Investment Income	5.3	6.3	4.4	4.0
Intergovernmental	74.8	73.9	70.0	59.4
All Other	<u>51.2</u>	<u>43.0</u>	<u>57.2</u>	<u>43.7</u>
Total Revenue	<u>\$1,200.7</u>	<u>\$1,200.2</u>	<u>\$1,229.0</u>	<u>\$1,231.9</u>

After two consecutive years of decline, income tax revenue in FY 2004 is projected to increase by 2.8% reflecting continued growth in personal income and a positive contribution from realized capital gains.

Revenue estimates are based on the assumption that the economy will expand by around 2.6% in 2003 and 4.0% in 2004. However, several scenarios are emerging that will have the potential to impact County General Fund revenue – both positively and negatively.

Baltimore County Economic Advisory Committee members indicated that County business conditions were good and expressed optimistic sentiments for the balance of 2003 and 2004.

FY 2004 revenue projections are based on expectations that the economy will grow at a 2.6% rate for all of 2003 and an accelerated 4.0% rate in 2004. This compares to growth rates of 0.3% in 2001 and 2.4% in 2002. However, new uncertainties are emerging and evaluating how these uncertainties will impact revenue is difficult. For example:

- In October RESI revised its CY 2003 personal income estimates for Baltimore County up by 49 basis points compared to their June 2003 forecast. This higher forecast would ordinarily suggest higher income tax receipts but increasing levels of mortgage debt and large carry-over capital losses may reduce taxable income and act to limit income tax receipts.
- The labor market over the last several years has experienced major deterioration; but from August through October 2003, national employment increased after declining for six straight previous months. Baltimore County and Maryland have not seen the loss of jobs that has occurred nationally.
- On a very positive note, the Baltimore County Economic Advisory Committee at its October 9, 2003 meeting indicated that, in most cases, business conditions in the County are good and are showing additional signs of improvement. Optimistic sentiments were echoed by the commercial and residential real estate sector representatives, as well as manufacturing, banking and other sectors. In fact, it was pointed out that while manufacturing nationally is still declining, locally and at the State level manufacturing is actually improving and is expected to continue the upward trend. But for all of the optimism expressed for the balance of 2003 and 2004, Committee members expressed notes of caution for beyond 2004. According to the Committee Chairman, Anirban Basu, roughly 10% of current consumer spending is debt based compared to a more normal level of 7%. If the “jobless recovery” trend along with professional service jobs being outsourced overseas continues, personal income growth will remain weak and the economic recovery could be in jeopardy in 2005.

## NATIONAL ECONOMIC INDICATORS

The U. S. economy grew at a strong pace in 2003:Q3 with GDP increasing at an annualized rate of 7.2%. Expectations are for a strong GDP growth over the balance of 2003 and into 2004.

Consumer spending in 2003:Q3 had its fastest growth in six years, while business fixed investment showed signs of life.

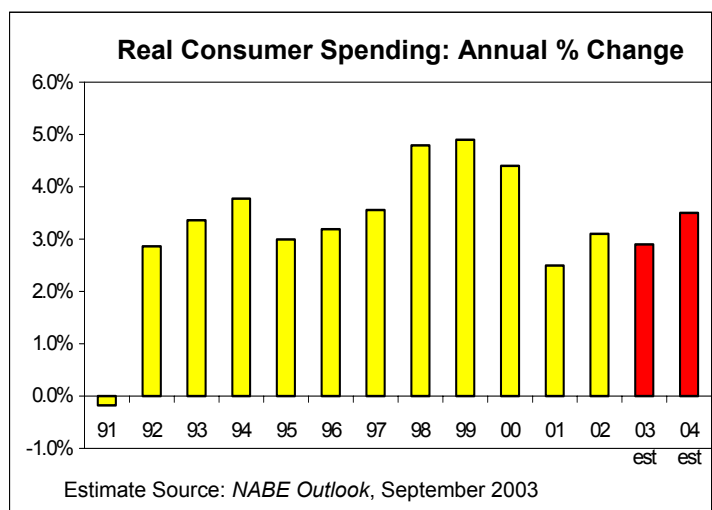
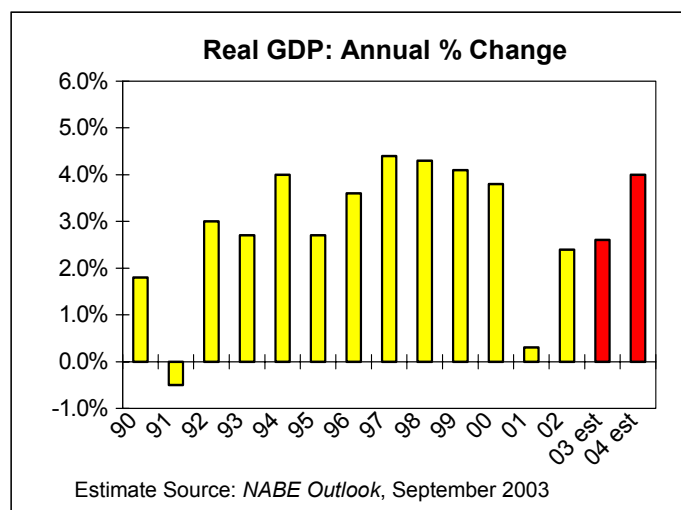
Although consumer confidence has been erratic in recent months, consumer spending continued strong helping to fuel the economy. Thus, consumers are saying one thing but act very differently.

Consumer confidence, after falling in September recovered in October and is well above the a nine-year low reached in March 2003.

**Real U.S. Gross Domestic Product (GDP)** increased by 2.4% in 2002, following a scant 0.3% increase in 2001. This represents the slowest back-to-back annual rates of growth since the 1990-1991 period when real GDP showed annual rates of change of 1.8% and -0.5%, respectively. In the most recent quarter, 2003:Q3, real GDP recorded an annualized growth rate of 7.2%, the fastest rate of expansion since 1984:Q1 when real output grew by 9.0%. In comparison, real GDP increased by an average of 3.8% annually from 1991 to 2000. The Fall 2003 NABE Outlook, released by the National Association For Business Economics on September 15, 2003, projected that GDP would expand at an annualized rate of 4.5% in 2003:Q3, 4.0% in 2003:Q4, and 2.6% for the year. Thus, 2003:Q3 GDP growth was sharply underestimated but the projection for 2003:Q4 is consistent with a recent survey by WSJ.com. For all of 2004, projected GDP growth is 4.0%, slightly above trend. Projections for real GDP growth are considerably more optimistic than the May 2003 NABE Outlook and reflect massive fiscal stimulus, in the form of tax cuts, improved business profitability, and monetary stimulus provided by the Federal Reserve. However, there are reasons for some caution as consumer spending has recently shown signs of slowing.

**Consumer spending**, which typically accounts for slightly more than two-thirds of all U.S. economic activity, increased at an annualized rate of 6.6% in 2003:Q3, the fastest pace in six years. Spending was supported in part by the recent tax cuts and by this spring's mortgage-refinancing boom. Durable goods consumption was especially strong and showed an annualized gain of 26.9%, following a 24.3% annualized gain in 2003:Q2. Gross private domestic investment showed an annualized gain of 9.3% in 2003:Q3, with nonresidential structures posting a decline of 2.4% and equipment and software up by a 15.4% annualized rate. In 2003:Q3, residential investment increased at an annualized rate of 20.4%, well above any recent quarterly showing.

**Consumer Confidence**, based on a survey of 5,000 U.S. households, rebounded sharply in October from its abrupt September decline. Given the October increase, overall consumer confidence is up by nearly 20 points since March 2003 when it hit a nine-year low due to war concerns and a weak economy and labor market. According to the Conference Board, consumers' appraisal of present-day conditions in October ended a five-month slide, and both the short-term business conditions outlook and the employment outlook were also more upbeat.



Short-term interest rates have not been at these sustained low levels since the late-1950s.

While interest rate cuts by the Federal Reserve have helped certain segments of the economy (e.g., housing), they as yet have not had a major stimulus effect on the economy as intended.

Since the summer lows in June, short-term interest rates have been relatively flat but long-term interest rates have increased.

The future direction of long-term interest rates is unclear, but short-term rates are likely to remain low.

From August 2002 to August 2003, consumer inflation was 2.2%, slightly ahead of recent trends. Inflation is forecast to increase by 2.3% in 2003 and by 1.6% in 2004.

**Interest rates**, especially short-term rates, are down considerably since December 2000. Starting on January 3, 2001, the Federal Open Market Committee (FOMC), the Federal Reserve's interest rate setting committee, has made thirteen interest rate cuts, bringing the federal funds rate down from 6.5% to the current rate of 1.0%, a level not consistently sustained since 1958. The 550 basis point cut in the federal funds rate (which other short-term interest rates generally follow) has not been especially effective in stimulating the economy. The milquetoast posture on the part of corporate executives, coupled with a more benign decline in long-term interest rates, (see table below), on which most investment decisions are based, has resulted in a sluggish economic performance. The current interest rate pattern shows that since the summer lows in June to October 30, the 90-day Treasury Bill rate has increased by 10 basis points, while the 10-year Treasury Bond rate has increased 116 basis points. The increase in long-term interest rates could reflect a market perception that the economy is poised for expansion and the future direction of interest rates is up, and/or transfers from bond funds to more attractive stock mutual funds.

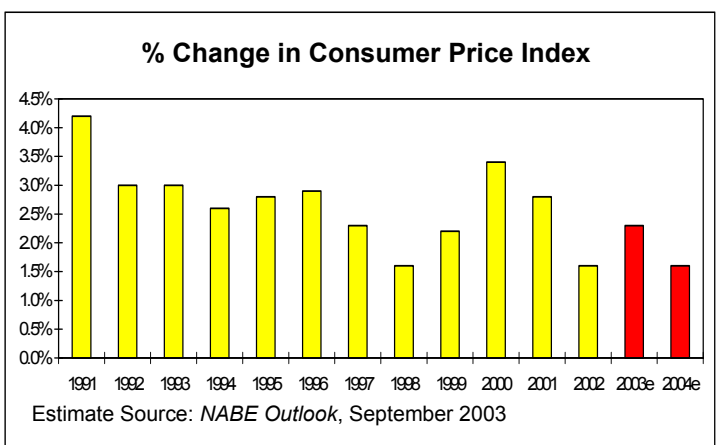
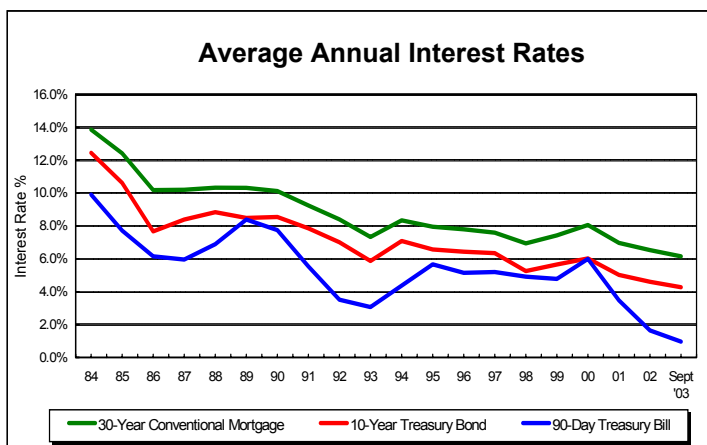
#### INTEREST RATE DECLINES FROM DECEMBER 2000 TO SEPTEMBER 2003

	Basis Points*
90-Day Treasury Bills	498
10-Year Treasury Bonds	97
30-Year Conventional Mortgage	123

\* A basis point is equal to .01 percentage points.

**The future direction of interest rates is unclear;** however, short-term rates are likely to remain low for an extended period. The FOMC press release following its October 28, 2003 meeting had a neutral bias stating that the upside and downside risks to sustainable economic growth for the next few quarters are roughly equal. However, the Committee further noted that "the probability, though minor, of an unwelcome substantial fall in inflation exceeds that of a rise in inflation." Under these conditions, current policies can be maintained for a "considerable period."

**Inflation**, as measured by the Consumer Price Index-All Urban Consumers, was 2.2% over the August 2002 to August 2003 period, slightly above the recent trend level. For 2002, the CPI increased by 1.6% and the current inflation forecasts for 2003 and 2004 are 2.3% and 1.6%, respectively, according to the *NABE Outlook*, September 2002. The last time the increase in the CPI was below 1.6% was in 1964 when inflation was 1.3%.



## THE LOCAL ECONOMY IN PERSPECTIVE

### EMPLOYMENT

County and State resident employment continues to grow despite a tough national labor market.

The number of County jobs decreased by 1.7% over the 2002:Q1 to 2003:Q1 period, while County employer payrolls were up by 2.3%. The number of County jobs is forecast to expand slightly in 2003.

The County's September unemployment rate was 4.8%, 0.7% point above the State average, but well below the national rate.

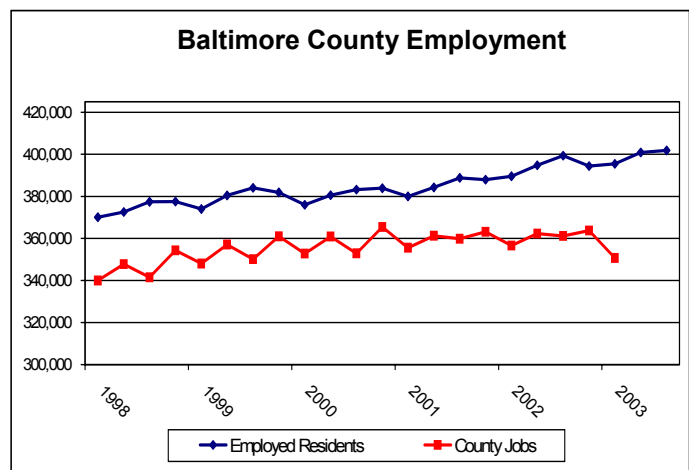
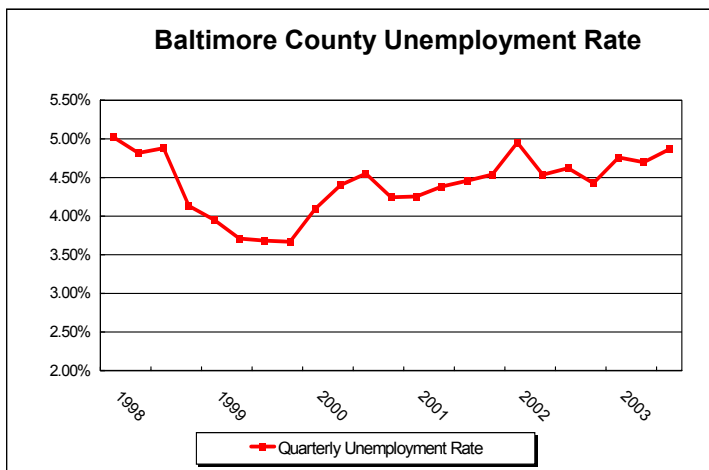
County job growth in 2003 is suspect; so too is how the change in County jobs will impact income tax revenue.

**Employment among County residents** increased by an estimated 2,557 persons, or by 0.6%, from 2002:Q3 to 2003:Q3. Over the same period, total employment of State residents increased by 0.7%. On a year-over-year basis from September 2002 to September 2003, Baltimore County and State resident employment increased by 0.1% and 0.3%, respectively, while national employment declined by 354,000 persons, or 0.3%.

**County jobs** data, which measures the number of jobs provided by most County employers, lags resident employment data by several quarters. The most recent data on County jobs show that from 2002:Q1 to 2003:Q1, County jobs decreased by 1.7% but payrolls rose by 2.3%, while at the State level, jobs declined by 0.3% and payrolls increased by 2.2%. Nationally, the non-farm payrolls lost nearly 320 thousand jobs over this same period, and since the recession officially began in March 2001, 2.4 million jobs have been cut. The October 2003 RESI forecast indicates that in 2003 the number of County and State jobs would increase by 0.2% and 0.5%, respectively. For 2004, County and State jobs are forecast to increase by 0.8% and 1.1%, respectively.

**Unemployment** among County residents increased by 1,220 persons over the 2002:Q3 to 2003:Q3 period, while the County's labor force expanded by 3,777 persons over the same period. The County's unemployment rate averaged 4.9% in 2003:Q3, up slightly from a year earlier. Within the Baltimore Metropolitan Area (BMA) the County's September unemployment rate of 4.8% was at the BMA average while Baltimore City's unemployment rate was 8.4%. Statewide, in September, the unemployment rate was 4.1%. (Due to labor market data adjustments from the U.S. Bureau of Labor Statistics, 2003 State and County data are not completely comparable to other earlier reporting periods.) Nationally, the unemployment rate was 6.0% in October, down 0.1% from September. From April through October 2003, the national unemployment rate was at or exceeded 6.0%, the first time unemployment exceeded 6.0% since mid-1994. However, in October, payrolls rose only for the third time in nine months.

Since income tax revenue is derived principally from earned income from jobs, County job projections suggest that for FY 2003 and FY 2004 income tax collections will be challenged.



## PERSONAL INCOME

Personal income growth in Baltimore County for FY 2004 was recently revised upward but still remains well below the January forecast used to establish the spending affordability growth factor.

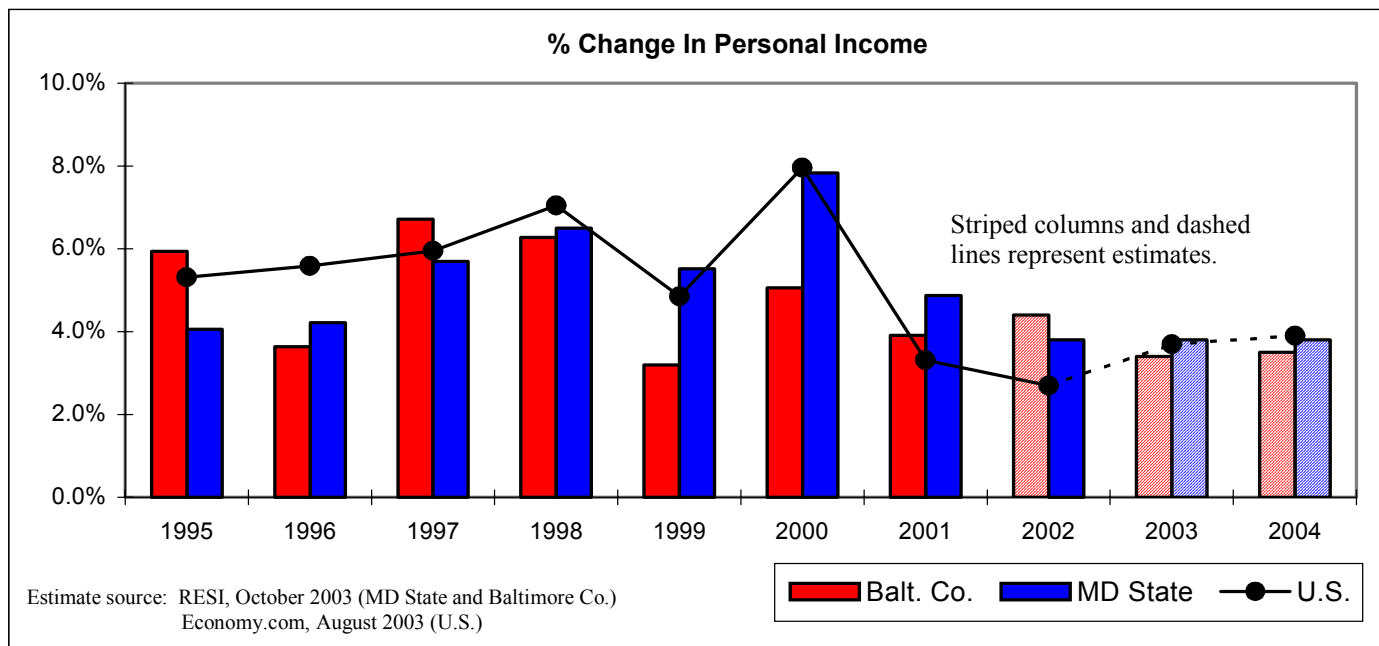
Personal income growth in Maryland continues to outperform that of the U.S.

The County's Spending Affordability Committee adopted a personal income growth rate of 4.32% for FY 2004, almost a full percentage point above the current forecast for personal income.

Given recent County and State employment trends, County and State personal income (PI) are likely moving close in tandem as they did over the 1990 to 1998 period. RESI's October personal income forecast shows PI in Baltimore County increasing by 3.6% and 3.4% in FY 2003 and 2004, respectively. For Maryland, PI was forecast to increase at a slightly quicker pace of 3.9% and 3.7% in 2003 and 2004, respectively. The October RESI PI forecast for FY 2003 for both Baltimore County and Maryland is down 22 basis points from their June forecast, while the October FY 2004 PI forecast is up slightly over 40 basis points from June. The October Baltimore County PI forecast for FY 2004, however, is nearly a full percentage point below the January PI forecast that was used in setting the spending affordability growth factor.

Despite slow emergence from the 2001 recession, PI in Maryland is increasing at a much faster pace than it is nationally. In 2001 and 2002, Maryland PI increased by 5.0% and 3.8%, respectively, well above the 3.3% and 2.7% increases recorded nationally. The most recent reading for State PI shows Maryland continuing to outperform the nation. From 2002:Q1 to 2003:Q1, Maryland PI increased by 4.0%, compared to 3.1% nationally. Nationally, PI slowed to 2.7% in the second quarter of 2003 from a year earlier reflecting the weak national employment situation. Nationally in 2003:Q2, wages and salaries made up 55.5% of PI with other important components including transfer payments, including social security (14.9%), interest income (11.8%), and dividend income (5.0%). Capital gains and losses are not part of personal income.

For FY 2004, the County Spending Affordability Committee adopted a spending affordability index of 1.0432 (4.32%), based on a PI forecast for the County that was produced by RESI in January 2003. However, revised October 2003 PI forecasts from RESI suggest that the spending affordability index, if based on the current forecast, would have been only 1.034 (3.4%). The FY 2004 Adopted Budget, however, was well below the recommended guideline based on lower revenue estimates; thus, the difference in the PI forecast would have had little impact on spending.



## EXISTING HOME SALES

**FY 2003 sales of existing Baltimore County homes were up by 0.4% compared to a year earlier, and resale activity still remains very strong.**

**County existing home prices have risen sharply in FY 2003.**

**August 2003 pending existing home sales were slightly above the August 2002 level. However, homes available for sale in the County remain scarce.**

**Higher home prices caused the monthly payment for the average-priced Baltimore County existing home sold to be 19.9% higher in August 2003 versus August 2002.**

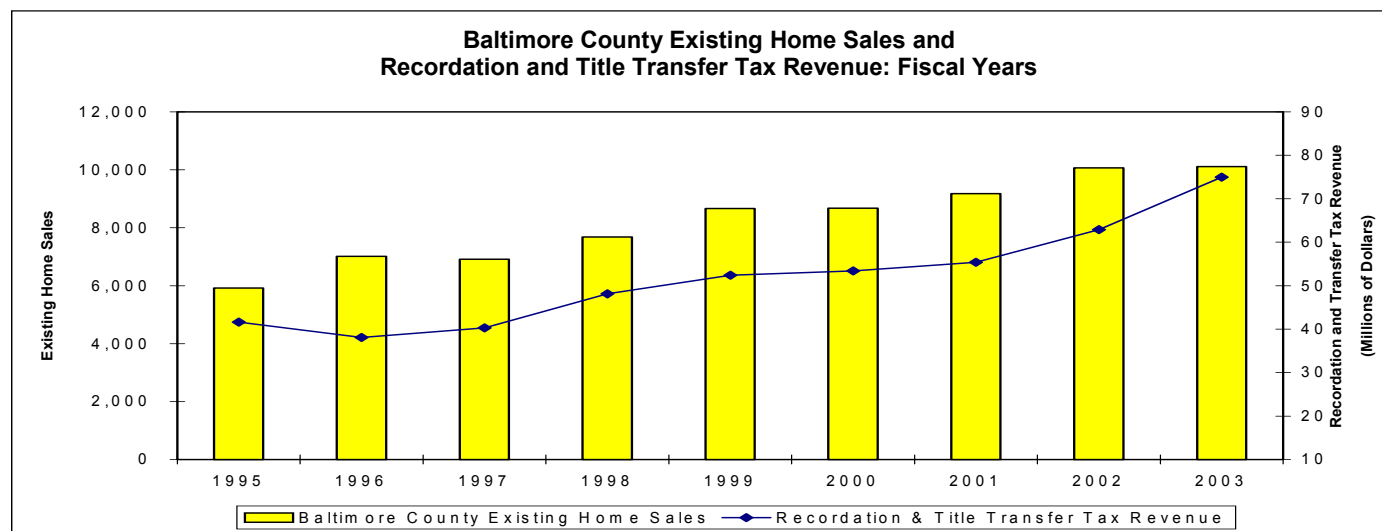
**Property-related transfer tax revenue is projected to contract in FY 2004.**

**Existing home sales** in Baltimore County in FY 2003 (July 2002 through June 2003) totaled 10,111 units, 0.4% above FY 2002. This gain comes on top of an impressive 9.7% increase in existing home sales in the previous fiscal year. Over the FY 2003 period, the average sale price of an existing home sold in the County was \$180,981, up 12.2% over FY 2002. Reflecting this increase, recordation and title transfer tax revenues in FY 2003 were up 22.9% and 17.1%, respectively, over FY 2002. For the first two months of FY 2004, existing homes sales in the County are 13.5% above FY 2003. For all of FY 2004, existing home sales are expected to continue strong but at a flat or slightly lower pace, reflecting high unemployment, nervous consumers, and an active inventory of homes for sale that is well below normal.

**Pending existing home sales** in August 2003 totaled 1,029 units, up by 45 units, or 4.6%, from August 2002. The increased level of pending existing home sales, despite the low inventory of homes for sale in the County, probably reflects consumers moving to take advantage of mortgage interest rates that are still very low by historical standards. (Mortgage interest rates for the week ending September 19, 2003 were 80 basis points above the 2003 trough of 5.21% for the week ending June 20 and 43 basis points below the 2003 high established during the week of September 5). In August 2003, the inventory of existing homes for sale in the County was 3.3% above the monthly average for FY 2003.

**Mortgage interest rates** in August 2002 and August 2003 were basically identical at 6.29% and 6.26%, respectively. Over this same period, the average price of an existing home sold in Baltimore County increased by 20.3% to \$217,335, compared to an increase of 16.2% to \$257,358 for the State of Maryland. Higher County home prices and flat interest rates caused the monthly principal and interest payment for the average-priced Baltimore County home (financed with a 30-year conventional mortgage loan and a 10% down payment) in August 2003 to increase to \$1,206, 19.9% above August 2002.

**Property-related transfer tax revenue** (recordation and title transfer taxes) increased by 19.2% in FY 2003, reflecting a record level of housing transactions at higher prices. In FY 2004, higher home prices will not be enough to offset fewer home sales and lower refinancing rates; as a result, property-related transfer tax revenue could decline by around 10%.



## CONSTRUCTION

The total value of new construction permits in 2003:Q2 increased 37.9% from a year earlier. The sheer volume of new projects will support construction employment over the next year or so, thus adding to the region's personal income growth.

Non-residential building activity weakened in 2003:Q2.

AAR activity in 2003:Q2 was 101.0% above a year earlier.

The value of new residential building permits fell slightly in 2003:Q2, mostly due to a sharp decline in multi-family permits.

**Construction permits** issued in Baltimore County in 2003:Q2 totaled \$294.6 million, \$80.9 million or 37.9% above the comparable 2002 period and 35.9% above 2001:Q2. 2003:Q2 was the strongest second quarter on record (since 1996) and nearly 35% higher than the 5-year second quarter average. Much of the increase, \$54.0 million, reflects the expansion of the County detention center. Several other larger projects helped to boost the 2003:Q2 number including a \$35 million addition at Sheppard Pratt Health System and a \$24.8 million addition to Mercy Hospital's senior living facility in the Cockeysville/Timonium area.

**New non-residential building** activity, perhaps the most volatile component of new construction, had a weak showing in 2003:Q2, with the value of non-residential building permits totaling \$15.6 million, \$7.3 million, or 31.7% below 2002:Q2, and nearly 50% below 2001:Q2.

**Additions, alterations, and repairs (AAR)** activity in 2003:Q2 totaled \$189.6 million, up by \$95.3 million, or a little over double the comparable prior year period. Reflecting strong existing home sales over the last few years, residential AAR activity in 2003:Q2 increased by \$14.4 million, or 76.4%, while non-residential AAR increased by \$80.9 million, or 107.2%. The three projects cited above accounted for \$113.8 million of the non-residential AAR activity. In 2003:Q2, the value of AAR construction permits accounted for nearly two thirds of all construction permits, compared to 44.1% in 2002:Q2 and 46.1% in 2001:Q2.

**New residential building permit** figures show 2003:Q2 total permits down by 26.1%, multi-family unit permits down 53.0%, and single-family unit permits down by 10.6% from a year earlier. Overall, the value of new residential permits in 2003:Q2 was 7.4% below 2002:Q2 but 3.9% above 2001:Q2. While the number of new residential permits issued can be quite volatile, and therefore makes year-over-year comparisons difficult, the value of new residential building permits continues to be influenced by the trend toward larger homes with more amenities.

